Before the
FEDERAL COMMUNICATIONS COMMISSION
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In the Matter of BELL ATLANTIC TELEPHONE COMPANIES Revisions to Tariff F.C.C. No. 10 Rates, Terms, and Regulations for Video Dialtone Service in Dover Township, New Jersey	Transmittal Nos. 741, 786 CC Docket No. 95-145

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To: Chief, Common Carrier Bureau

OPPOSITION TO DIRECT CASE

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OPPOSITION TO DIRECT CASE

Pursuant to the Common Carrier Bureau's Order Designating Issues For Investigation,[1] the New Jersey Cable Television Association ("NJCTA") hereby submits its Opposition to Bell Atlantic's Direct Case in support of its tariff introducing commercial video dialtone service in Dover Township, New Jersey.

[1] Bell Atlantic Tel. Cos. Revisions to Tariff F.C.C. No. 10, Transmittal Nos. 741, 786, Order Designating Issues for Investigation, DA 95-1928 (Com. Car. Bur. released Sept. 8, 1995) ("Investigation Order").

INTRODUCTION AND SUMMARY

On July 18, 1994, the Commission released an Order authorizing Bell Atlantic to construct and operate the first commercial video dialtone system, in Dover Township, New Jersey.[2] In the Dover Order, the Commission responded to concerns raised by competitors and consumers regarding the clear threat of cross-subsidization posed by Bell Atlantic's Application by emphasizing that it would carefully scrutinize the economics of Bell Atlantic's construction and operation of the system during the tariff review process.[3] On January 27, 1995, Bell Atlantic filed Transmittal No. 741 introducing the terms, conditions and rates for developing and deploying the first offering of video dialtone service on a permanent commercial basis in Dover.[4] This proceeding now presents the Commission with its sought after opportunity to carefully scrutinize whether Bell Atlantic's video dialtone service is economically justified without cross-subsidization from Bell Atlantic's telephony revenues.

In Petitions to Reject Bell Atlantic's tariff, interested parties, including NJCTA, demonstrated numerous problems and deficiencies that made Bell Atlantic's tariff patently unlawful. In the alternative, Petitioners argued that the problems and deficiencies in Bell Atlantic's tariff warranted its suspension and an investigation into its lawfulness. In an Order released June 9, 1995, the Bureau denied the Petitions to Reject, suspended Bell Atlantic's

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[2] New Jersey Bell Tel. Co., Order and Authorization, 9 FCC Rcd. 3677 (1994), pets. for recon. pending ("Dover Order").

[3] Dover Order, ¶ 42, and separate statement of Commissioner Andrew C. Barrett.

[4] Bell Atlantic Tel. Cos. Revisions to Tariff F.C.C. No. 10, Transmittal No. 741 (Jan. 27, 1995), as revised, Transmittal No. 786 (June 8, 1995).

tariff for one day, and stated that it would initiate an investigation of the tariff's rates, terms, and conditions.[5] On September 8, 1995, the Bureau released its Investigation Order in this docket, designating sixteen issues for investigation, and requiring Bell Atlantic to provide detailed responses to specific questions pertinent to each designated issue.

Bell Atlantic filed its Direct Case on October 26, 1995, consisting of multiple volumes of charts, tables, affidavits, and text. Despite the volume of material submitted, Bell Atlantic failed to meaningfully respond to many of the Bureau's specific questions, and moreover, confirmed that Bell Atlantic's video dialtone service in Dover will be massively cross-subsidized absent Commission action. Attached to this Opposition is the Declaration of telecommunications economist Leland L. Johnson, Ph.D. In his declaration, Dr. Johnson demonstrates that Bell Atlantic, by virtue of its cost allocations and pricing, "is seeking to subsidize its entry into video, in competition with cable operators and other suppliers, with revenues from its monopoly local telephone ratepayers."[6] Indeed, Dr. Johnson concludes that Bell Atlantic plans to replace its existing phone lines in Dover with a new fiber network to carry both telephone and video dialtone signals "while intending to charge off two-thirds of the whole investment to telephony."[7] Dr. Johnson reaches this conclusion on the basis of four observations. First, Bell Atlantic assigned to the voice portion of the new network investment

[5] Bell Atlantic Tel. Cos. Revisions to Tariff F.C.C. No. 10, Transmittal Nos. 741, 786, Order, DA 95-1285 (Com. Car. Bur. released June 9, 1995). ("Suspension Order").

[6] Declaration of Leland L. Johnson, Ph.D. at 2 (Attached hereto as Attachment A) ("Johnson Decl.").

[7] Id.

far in excess of the investment required for a stand-alone network with the same narrowband capability. Second, Bell Atlantic has treated overhead as a fixed common cost, rather than a variable common cost, increasing substantially for the provision of video dialtone services. Indeed, Bell Atlantic has assigned only a 20% overhead loading to video dialtone. Third, Dr. Johnson notes that tariff rates would have to more than double to cover actual and incremental costs, plus the share of fixed common costs utilizing Bell Atlantic's own methodology. Finally, Dr. Johnson completely rebuts Bell Atlantic's claim that price cap regulation eliminates the possibility of cross-subsidy. Indeed, Bell Atlantic essentially admits to the subsidy by asserting that its other services could be priced above stand-alone costs, and video dialtone priced above average incremental costs.[8] Dr. Johnson notes that this statement is most revealing. "If every other service is priced above stand-alone cost, and VDT is priced above average incremental costs, the firm *must be collecting excess profits*."[9]

Moreover, Dr. Johnson notes that Bell Atlantic admits that it could not allocate all of the costs to video because "market conditions" might not permit the recovery of such a large mark-up.[10] If in fact video dialtone services are not permitted to recover their fair share of the overhead costs because of video dialtone market conditions, Bell Atlantic is essentially admitting to cross-subsidy.[11] While it is easy to understand Bell Atlantic's desire to minimize

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[8] Direct Case, Attachment A, Affidavit of William E. Taylor, at 11.

[9] Johnson Decl. at 16 (emphasis in original).

[10] See, e.g., Direct Case, Taylor Affidavit at 7.

[11] Johnson Decl. at 26.

the pricing for its video dialtone service, and assign as much of the cost of rebuilding its network as possible to telephony, such subsidies are not worthy of administrative sanction in the name of competition, market conditions, or policy. The costs of establishing the network are simply the costs of competing. If the competing service is uneconomic, then no rationale exists for encouraging its deployment.

Other specific instances in Bell Atlantic's Direct Case show that its tariff rates fail to recover the direct costs of providing video dialtone service in Dover, and therefore are predatory and unlawful. For example, Bell Atlantic's definition of the equipment considered "shared" or "jointly used" is constantly changing, thus indicating that Bell Atlantic has not properly assigned and allocated costs between video and voice accounts. Bell Atlantic has also stubbornly refused to include start-up costs in calculating the rates it will charge programmer-customers. Bell Atlantic's video dialtone rates, therefore, will not recover all the costs of the system — as any normal business's rates would have to — and are thus by definition predatory and unlawful.

Moreover, Bell Atlantic insists that it will not incur any additional administrative or marketing type expenses as a result of its introduction of video dialtone service in Dover. That assertion is, of course, quite unrealistic, and simply indicates how extreme a position Bell Atlantic must adopt in order to justify its otherwise unreasonable, predatory prices. As Dr. Johnson points out, in addition to failing to admit to increased expenses, Bell Atlantic has allocated an unreasonably low amount of overhead to its video accounts. The failure of Bell Atlantic's rates to include a reasonable and proper allocation of overhead expenses violates the Commission's Video Dialtone Recon Order,[12] and demonstrates that the rates cannot be allowed to continue in effect. Bell Atlantic also continues to maintain that it was correct in using capacity costing to develop its rates, despite the clear demonstration by NJCTA in its Petition to Reject that such a methodology failed to recover the costs of the system, making the proposed rates predatory and unlawful.

Bell Atlantic's allocation of pole and conduit costs to its video dialtone system unreasonably discriminates against competing cable operators. In addition, Bell Atlantic fails to demonstrate that its refusal to allow part-time or occasional programmers to lease capacity (due to its three-month minimum lease term requirement) is not unreasonably discriminatory. Finally, Bell Atlantic's Direct Case fails to justify Bell Atlantic's interest rate policies, as required by the Bureau.

The fact that voice and video can be provided over an integrated "broadband" network does nothing to respond to key questions of cost causation and allocation. It appears that Bell Atlantic is committed to building the broadband network no matter how technology, market conditions, and regulatory requirements interact. Yet, this blind commitment to compete with cable and expand its range of services does not justify subsidizing the complete rebuild of its narrowband network. Rather, the Commission must closely examine the process

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[12] Telephone Company-Cable Television Cross Ownership Rules, Sections 63.54-63.58, Memorandum Opinion and Order On Reconsideration and Third Further Notice of Proposed Rulemaking, 10 FCC Rcd. 244 (1994) ("Video Dialtone Recon Order").

by which Bell Atlantic calculated and then allocated its costs. To the extent the allocation is tilted away from video to telephony, the Commission must require Bell Atlantic to clearly show why the telephone portion of its network is superior to the network as it exists today, or the network with a modest upgrade.

> The key question is: How does extension of fiber all the way to the curb, instead of to a neighborhood node (the digital loop carrier architecture), sufficiently enhance the capability of the network for *narrowband* applications to justify a cost assignment to telephony far in excess of the cost of building an entirely separate narrowband system?[13]

Bell Atlantic has not responded to these issues in its Direct Case. Yet, without Bell Atlantic's complete response on these issues, the cost allocation scheme adopted by Bell Atlantic, and the tariff prices that result, must be rejected as patently unlawful. In order to further illuminate these issues, NJCTA's Opposition will address each of those points using, to the extent possible, the issue headings employed by the Bureau in the Investigation Order and Bell Atlantic in its Direct Case.

I. BELL ATLANTIC'S RATES MUST RECOVER THE START-UP COSTS OF ITS DOVER SYSTEM, OR ITS RATES WILL BE PREDATORY, ANTICOMPETITIVE, AND UNLAWFUL

In Issue D, the Bureau sought to determine whether Bell Atlantic had properly identified and included costs and expenses, other than primary plant, incurred by Bell Atlantic in constructing the Dover system.[14] Particularly, in Issue D, the Bureau required Bell Atlantic to provide information regarding the recognition and allocation of "preliminary expenses"

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[13] Johnson Decl. at 10.

[14] Investigation Order, ¶¶ 28-32.

incurred for the Dover video dialtone system. For example, in paragraph 31 of the Investigation Order, (what Bell Atlantic deems D(3)), the Bureau requires Bell Atlantic to "provide the costs of the preliminary planning for video dialtone and the development expenses incurred prior to the approval of the Dover Township Section 214 authorization."[15] Bell Atlantic, however, essentially refuses to respond to the Bureau's inquiries.

In its Direct Case, Bell Atlantic states that "[i]t clearly is unreasonable to use start-up expenses for the first commercial video dialtone service, if they were in fact identifiable (which they are not), as a proxy for long-run market conditions."[16] Bell Atlantic maintains this position throughout its responses under Issue D, asserting that preliminary expenses cannot be identified because the Dover Township and Florham Park systems were planned concurrently.[17] Moreover, Bell Atlantic asserts that even if they could be identified, the costs incurred prior to providing video dialtone service in Dover should not be recovered specifically by the Dover system, but rather, because the planning will benefit future Bell Atlantic video dialtone systems, the cost should be recovered through overhead loadings applied across all services.[18] Bell Atlantic, however, is incorrect, and the fact that its rates fail to recover such costs makes them predatory and unlawful.

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[15] Investigation Order, ¶ 31.

[16] Direct Case at 52.

[17] Direct Case at 59-61.

[18] Direct Case at 59-61.

First, Bell Atlantic's assertion that it cannot identify the preliminary costs associated with the Dover system is highly unrealistic, or worse, if true, indicative of a serious problem with Bell Atlantic's internal accounting and audit procedures. For example, Bell Atlantic states that "attorneys working on the Dover Township regulatory issues are responsible for numerous other dockets at the Commission as well as filing in other jurisdictions, some or all of which may be video dialtone related. It is not possible to parse these types of employee expenses and apportion them to specific products or services or geographic locations."[19] Clearly, Bell Atlantic's assertion is not credible, given that attorneys in private firms and the government keep track of the time they spend on different issues, often down to the tenth of an hour. Surely, Bell Atlantic similarly keeps track of the time its attorneys spend on specific issues. It is untenable for Bell Atlantic to assert that because its attorneys, and presumably other employees, such as engineers and economists, work on multiple projects, it cannot keep track of the time they spend on any one project.

Second, Bell Atlantic's assertion that such start-up costs should not be recovered as direct costs of the Dover system, but rather, as part of overhead costs recovered by all Bell Atlantic services is contrary to public policy and requirements set forth in the Video Dialtone Recon Order. In the Video Dialtone Recon Order, the Commission stated that while carriers ordinarily decide whether to include in their costs any categories of costs in addition to primary plant, the Commission also stated that because of the incentive for LECs to understate the cost of video dialtone service, it would require "carriers to treat costs in

[19] Direct Case at 52.

other accounts as direct costs if those costs are reasonably identifiable as incremental costs of video dialtone service."[20] The other costs the Commission identified as likely being reasonably identifiable incremental costs of video dialtone included, *inter alia*, testing, engineering, and legal. Given that Bell Atlantic is capable of determining such costs as they relate to the Dover system without difficulty, it would be in violation of the Commission's explicit requirements for the recovery of video dialtone costs for Bell Atlantic to fail to treat them as direct costs of video dialtone.

In addition to being contrary to the Commission's explicit video dialtone requirements, Bell Atlantic's assertion that the start-up costs of the Dover system should be recovered by all services is contrary to sound economic and public policy. In response D(5), Bell Atlantic states that "it is unreasonable to require the first video dialtone service in the first geographical area of deployment to bear all of the start-up costs associated with entry into the video dialtone market . . . [because] [a]ny preliminary expenses incurred to the benefit of the Dover Township and Florham Park projects also benefit Bell Atlantic's future video dialtone projects."[21] Bell Atlantic's assertion suffers two fatal flaws. First, at this point in time it appears unlikely, at best, that Bell Atlantic will pursue "future video dialtone projects." Bell Atlantic has already withdrawn its applications to provide video dialtone

[20] Video Dialtone Recon Order, ¶ 219. Bell Atlantic's assertion, Direct Case at 61, that the Commission's statement does not require Bell Atlantic to include start-up costs as direct costs because they are not "reasonably identifiable" with video dialtone is of no avail in light of the previous discussion demonstrating that costs, such as legal, engineering, and planning, can easily be identified as associated with a particular service, location, and issue.

[21] Direct Case at 60.

service throughout its telephone service area, and has shown no signs of re-initiating those applications.[22] Moreover, the trend amongst most LECs is to abandon video dialtone plans, and even authorizations, in favor of stand-alone cable systems.[23] Bell Atlantic cannot, therefore, be allowed to maintain as unrecovered the massive start-up costs of its Dover system for "possible" recovery by non-existent future systems. For when those services never materialize, the unrecovered costs of the Dover system will fall on telephone ratepayers. Moreover, allowing Bell Atlantic to absorb the costs of its expensive and untested new service gives it an unfair competitive advantage over normal companies that do not have monopoly revenue streams to support their new ventures.[24]

Bell Atlantic's rates for video dialtone service must reflect and recover the entire cost incurred in planning, developing, and obtaining authorization for the Dover system.

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[22] Letter from Edward D. Young, Vice President of Bell Atlantic, to Kathleen Wallman, Chief, Common Carrier Bureau (May 24, 1995). Indeed, Bell Atlantic has even utilized different architectures for its Florham Park and Dover systems, and any new system may well use an entirely different architecture. The Dover start-up costs would then simply remain an unrecovered cost of developing and deploying the Dover video dialtone service, in violation of the Commission's requirements.

[23] See, e.g., Plymouth Township, Michigan Becomes First to Grant Cable Franchise to Ameritech, Common Carrier Week, July 3, 1995.

[24] To the extent that Bell Atlantic attempts to provide the costs incurred by the Dover system prior to authorization, its purported costs are unrealistically low. While it is impossible to determine what is included in the accounts listed by Bell Atlantic, even if the entire expense were incurred by legal personnel, it strains the bounds of credulity to accept that Bell Atlantic's lawyers, assuming even a below-market rate such as $150/hour, could have created the thousands of pages of filed pleadings, and the numerous hours spent lobbying the Commission in *ex parte* meetings, for only $250,000.

They presently do not do so, and thus they must be rejected and service suspended until such time as appropriate rates are developed and approved.

II. BELL ATLANTIC'S RATES WILL NOT RECOVER A REASONABLE AND PROPER AMOUNT OF OVERHEAD COSTS

In the Video Dialtone Recon Order, the Commission stated that in the usual access case, carriers bear the burden of justifying why their overhead loadings do not produce a final rate that is unreasonably high.[25] In the case of video dialtone, however, the Commission has recognized that LECs have an overwhelming incentive to understate the costs of providing the service to produce an unreasonably low, predatory rate.[26] Accordingly, the burden is on Bell Atlantic to justify why its overhead loadings do not produce an unreasonably low final rate. Bell Atlantic has failed to meet that burden.

In calculating its tariff rates, Bell Atlantic assigned to its video dialtone service an overhead loading factor of 1.2 (or 20%), and to its volume and term discounted packages an overhead loading factor of only 1.06 (or 6%). In the Investigation Order, the Bureau recognized that these overhead loading factors appeared unreasonably low and warranted investigation.[27] Accordingly, the Bureau instructed Bell Atlantic to provide information justifying the overhead loading factors.[28]

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[25] Video Dialtone Recon Order, ¶ 220.

[26] Id., ¶ 216.

[27] Investigation Order, ¶¶ 33-36.

[28] Investigation Order, ¶¶ 35-36.

In response to the Bureau's inquiry, Bell Atlantic, first, attempts to obfuscate the issue by asserting that its "calculation of its price *ceiling* for each rate element complies with the Commission's requirements."[29] In the case of video dialtone, however, as opposed to interstate access services and as the Commission has recognized, the concern is not that Bell Atlantic may charge too high a rate. Rather, the concern in video dialtone is that Bell Atlantic will not allocate sufficient overhead to its rates, in order to undercut its competitors with predatory rates. This critical distinction must be kept at the forefront in analyzing Bell Atlantic's overhead loadings and video dialtone rates.

A. Bell Atlantic Has And Will Incur Substantially Increased Overhead Costs By Providing Video Dialtone Service

Bell Atlantic's second line of response to the Bureau's inquiry is that "Bell Atlantic's introduction of video dialtone service will not cause incremental increases in its overhead expenses, including marketing, customer service, engineering and advertising expenses," and therefore, "customers of other telephone services are by definition better off with *any* contribution to overhead borne by this new service."[30] Bell Atlantic's assertion, again, is extremely unrealistic, at best. By introducing video dialtone service in Dover Township, Bell Atlantic has already incurred and will continue to incur substantial increases in overhead expenses, particularly marketing, customer service, engineering, and advertising

[29] Direct case at 62 (emphasis added).

[30] Direct Case at 62 & n.54. Bell Atlantic's statement is further flawed, as video dialtone is not a telephone service.

expenses.[31] Regardless of what Bell Atlantic asserts, both end-users and programmer-customers will contact Bell Atlantic directly with complaints and inquiries, thus increasing customer service expenses. Moreover, Bell Atlantic has incurred, and will undoubtedly continue to incur, advertising and marketing expenses, as it seeks to sell its new service to both end-user subscribers and programmer-customers. While programmer-customers will market their service directly to end-users of Bell Atlantic's system, Bell Atlantic will still need to market *system* subscriptions to end-users. Ultimately, Bell Atlantic's failure to recognize these expenses as related to video dialtone simply demonstrates that Bell Atlantic's proposed rates are based on cross-subsidization, as increased overhead expenses will be incurred, and if not recovered by video dialtone rates, the expenses will fall on telephone ratepayers.

B. Bell Atlantic's 20% Overhead Loading Is Unreasonably Low

In response to the Bureau's inquiry regarding its 20% overhead loading for standard video dialtone services, Bell Atlantic asserts only that video dialtone will have to compete with others providers for market share, and other Bell Atlantic services have comparable overhead loadings.[32] Such an assertion, however, fails to carry Bell Atlantic's burden of proving that its 20% overhead loading is reasonable. First, the fact that other Bell Atlantic services are generally assigned 30% overhead loadings, or more, merely demonstrates that Bell Atlantic's 20% loading is too low. Further, comparing the overhead loadings Bell

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[31] See Johnson Decl. at 21-22.

[32] Direct Case at 64.

Atlantic assigns to other services, such as interstate access services, which clearly do not cause nearly as great overhead expenses, demonstrates that Bell Atlantic's video dialtone rates will not recover a reasonable amount of overhead. For example, Bell Atlantic assigns 473% overhead loadings to its DS3 Direct Trunk Termination — Channel Mile per mile in Zone 1. Yet, Bell Atlantic provides no *valid* cost explanation of why its proposed video dialtone rates should recover less overhead than such other services.[33]

In his declaration, Dr. Johnson demonstrates that Bell Atlantic's video dialtone rates should recover a 65% overhead loading. Dr. Johnson calculates this overhead loading by comparing the relationship of overhead expenses and revenues attributable to Bell Atlantic services generally.[34] Dr. Johnson further explains that only if it is clear that video dialtone will generate less, or more, overhead than other services, would it be appropriate to load a lesser or greater percentage onto video dialtone.

Bell Atlantic's reliance on the asserted market impact of increasing video dialtone's overhead loading merely demonstrates that its video dialtone service will be unlawfully cross-subsidized and anti-competitively priced. For example, Bell Atlantic's statement that its lower than usual overhead loadings are required because "[u]nlike most other new services launched by Bell Atlantic, video dialtone will compete . . ." indicates one

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[33] Bell Atlantic's assertions are based on the invalid assertion that video dialtone service will not incur any overhead expenses.

[34] Johnson Decl. at 20-24.

of two possibilities, both of which are problematic.[35] Bell Atlantic's statement either indicates that in order for its video dialtone system to be competitively viable it must be priced below the cost it incurs, or it indicates that for its other services, where it faces no competition, Bell Atlantic imposes unreasonably high, monopoly overhead loadings, and thus earns excess profits. Bell Atlantic has filed extensive evidence and documents asserting that the overhead loadings it imposes on its other services, such as interstate access, are reasonable and proper.[36] Accordingly, Bell Atlantic's statement must indicate that its video dialtone service is being assigned an unreasonably low overhead loading. Indeed, Dr. Johnson has demonstrated that the proper loading of 65 percent, versus the 20 percent loading adopted by Bell Atlantic, greatly undermines the cost basis for the video dialtone rates.[37] While understating the costs may allow Bell Atlantic to enter the market in the short run, in the long run, allowing Bell Atlantic to undercut its competitors using predatory prices ultimately will harm competition and the public interest.

C. Bell Atlantic's 6% Overhead Loading Factor For Volume And Term Discounted Services Is Unsupported, Highly Unreasonable, And Predatory

In the Video Dialtone Recon Order, the Commission stated that it would not consider a 0% allocation of overhead reasonable absent a substantial showing.[38] In

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[35] Direct Case at 64.

[36] See, e.g., Direct Case, Attachment J (Bell Atlantic attaches several of its interstate access tariffs).

[37] Johnson Decl. at 26.

[38] Video Dialtone Recon Order, ¶ 220.

developing its tariff rates, Bell Atlantic used an overhead loading of only 6% in creating its rates for volume and term discounted services.[39] Clearly, there is little difference between the unreasonable 0% and Bell Atlantic's 6%. Accordingly, in the Investigation Order, the Bureau instructed Bell Atlantic to present evidence justifying its unreasonably low 6% overhead loading.[40] In its Direct Case, Bell Atlantic fails to present concrete evidence justifying its 6% loading, and therefore, its volume and term discount rates must be found unlawful.

Bell Atlantic presents two rationales for its 6% overhead loading, both of which are to no avail. First, Bell Atlantic asserts, again, that the introduction of a new service, video dialtone, will not cause any increase in overhead costs, and therefore, any contribution to overhead is reasonable.[41] As explained above, and in Dr. Johnson's Declaration, however, Bell Atlantic's assertion is untenable. The introduction of video dialtone will cause Bell Atlantic to incur significantly increased overhead costs, such as advertising, engineering, and customer service. Unless they recover those increased overhead costs, Bell Atlantic's volume and term discount rates are predatory and unlawful.

Second, Bell Atlantic asserts that "cost savings" associated with multiple channel, multiple year deals justify the lower overhead loading factor.[42] Bell Atlantic,

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[39] Investigation Order, ¶ 34.

[40] Investigation Order, ¶ 36.

[41] Direct Case at 66.

[42] Direct Case at 68.

however, presents no data demonstrating the cost savings associated with high-volume, long-term service deals. Indeed, Bell Atlantic's assertion that it will incur lower costs when providing high-volume conflicts with its statement that the system is not usage sensitive.[43] For example, Bell Atlantic compares its provision of volume and term discounts to "Buy one, get one free" and "Family Pack Savings" type offers. Neither of these analogies, however, supports Bell Atlantic's unreasonably low overhead loading. "Buy one, get one free" advertisements are so called "loss leaders." Businesses making such offers do not maintain that they are incurring lower costs by giving one item away for every item sold. Rather, the business absorbs the loss in hopes that while consumers are in the business, they will purchase other items at full price. Such a situation does not work for Bell Atlantic. While Bell Atlantic is undoubtedly taking a loss on its volume and term discounted rates, programmers are not going to impulsively purchase a few extra channels at full price. Moreover, in the case of "Family Pack Savings" offers, where manufacturers sell high volumes of their product for less, for example a 2-liter bottle of Coca-Cola as opposed to a single 12 ounce can,[44] the lower cost reflects a reduction in production or packaging costs. In the case of Bell Atlantic's video dialtone system, however, the investment cost and overhead expense per channel will not significantly change; at least, in its Direct Case, Bell Atlantic has not presented any evidence demonstrating the overhead expense savings it will incur by providing long-term or high-volume packages. Indeed, Bell Atlantic asserts that the cost of its system is not sensitive to use. Accordingly, Bell Atlantic has failed to carry its burden of

[43] Direct Case at 25.

[44] Direct Case at 70.

demonstrating that its 6% overhead loading is reasonable, and its rates must be found unlawful.

III. BELL ATLANTIC FAILS TO DEMONSTRATE THAT ITS CAPACITY COSTING METHODOLOGY WILL RECOVER THE COSTS OF ITS VIDEO DIALTONE NETWORK

In its Petition to Reject, and in its Response to Bell Atlantic's supplemental information, NJCTA demonstrated that Bell Atlantic's "capacity costing" methodology was fundamentally flawed, as it would not fully recover the costs of the video dialtone system.[45] Under its capacity costing methodology, Bell Atlantic calculated the price per channel for video dialtone service based on the total number of potential channels on the system rather than the number of channels Bell Atlantic predicted would be used.[46] As a result, in Bell Atlantic's representative year, where only 304 channels on the system will be subscribed to and used, the prices charged will not recover the full cost incurred by the system.[47] In response to NJCTA's point, Bell Atlantic has asserted that "other" services provided over the system will recover the additional costs of the system.[48]

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[45] NJCTA Petition at 11-12.

[46] Suspension Order, ¶ 37.

[47] Transmittal 741 D&J at 5-19; Suspension Order, ¶ 59. In its original tariff workpapers, Bell Atlantic predicted that during the representative year, demand would exist for 262 channels. After its early enrollment period, however, Bell Atlantic revised its prediction to 304 channels. The Bureau accepted Bell Atlantic's modification in the Suspension Order.

[48] Mulieri Letter at 1, 3 (May 16, 1995); Suspension Order, ¶ 35.

Recognizing the cost recovery gap left by Bell Atlantic's capacity costing methodology, in the Investigation Order, the Bureau instructed Bell Atlantic to provide specific information regarding how the costs of the 79 channels that were projected to be unused in Bell Atlantic's representative year would be recovered, including the projected cost of providing the "other" services that would assertedly utilize and recover the remaining 79 channels.[49] In response, Bell Atlantic proffers several assertions to support its capacity costing methodology and the recovery for the 79 channels.

First, Bell Atlantic argues, again, that it would be unfair to charge the first service on the system with recovering all the costs of the system.[50] As discussed above, however, in the case of Bell Atlantic's video dialtone system, there can be no confidence that any of the "other" services discussed by Bell Atlantic will ever be deployed. Allowing Bell Atlantic to ignore a substantial portion of the cost incurred in constructing its video system under the hope that some day, services which do not presently exist will recover those costs would be irresponsible public policy. Telephone ratepayers, who would be forced to bear the unrecovered costs, and competitors, who would be forced to compete with cross-subsidized, predatory prices, would each suffer irreparable harm.

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[49] Investigation Order, ¶¶ 39-40.

[50] Direct Case at 73-74.

Second, Bell Atlantic asserts that in 1996 or 1997 it will introduce "pointcast" services, which will use the remaining 79 channels.[51] Assuming, for the sake of argument only that such services will actually enjoy sufficient market demand to make them viable, a point which Bell Atlantic has failed to demonstrated throughout the video dialtone application process, Bell Atlantic's assertion that pointcast services will recover the cost of the remaining 79 channels is fatally flawed. In its Direct Case Bell Atlantic calculates the price per subscriber that would be required for pointcast services to recover the remaining costs of the 79 channels by using the monthly cost per channel per potential subscriber of $0.0354 multiplied by the remaining channels (39 according to Bell Atlantic) divided by the 35% penetration it expects for these services.[52] Bell Atlantic, therefore, asserts that pointcast services would only have to recover $3.94 per subscriber per month to cover the costs of the system.

Bell Atlantic's calculation and assertion fail in several ways. As noted above, Bell Atlantic's sudden claim that demand for broadcast channels will increase by 40, thus leaving only 39 unused channels in the representative year, is entirely unsubstantiated and thus must be ignored. Using every other element of Bell Atlantic's calculation, but changing

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[51] Direct Case at 76. As part of its assertion on this point, Bell Atlantic attempts to revise yet again its projected demand for broadcast video dialtone service, claiming that demand will increase by 40 channels over the next 5 years. Id.; see also Attachment Pre(3). Bell Atlantic provides no support for this assertion, however, and it should be ignored. Bell Atlantic cannot be allowed to repeatedly alter its projected year calculations simply to satisfy its present needs.

[52] Direct Case at 77-78.

the number of channels to 79 increases the amount per subscriber that will have to be recovered to \$7.99 per subscriber per month.[53] Clearly, Bell Atlantic cannot, without substantial additional evidence, proclaim that subscribers will be willing to pay \$7.99 per month -- *in addition to the video dialtone charges they would already be paying* -- for presently non-existent services. Moreover, asserting that the remaining 79 channels will be used simply attempts to alter Bell Atlantic's representative year; it does not remedy the flaw in its capacity costing methodology.

In addition, Bell Atlantic's assertion regarding the development of pointcast services and their recovery of the costs of the 79 channels left unused in Bell Atlantic's representative year is flawed because it ignores the substantial additional costs that Bell Atlantic will be required to incur to implement such services. Bell Atlantic states in its Direct Case that "Bell Atlantic's business plans call for deployment of asynchronous transfer mode (ATM) equipment necessary for initial pointcast service in 1996, and for expansion of pointcast capabilities in 1997."[54] Yet, Bell Atlantic did not include the substantial cost of deploying ATM equipment when it calculated the cost per month per channel per subscriber. The \$0.0354 cost cited by Bell Atlantic does not include the cost of ATM equipment. Further, Bell Atlantic completely ignores the costs of its unexplained "expansion of pointcast capabilities in 1997." Indeed, Bell Atlantic's statement supports a point discussed by Dr. Johnson. Namely, Bell Atlantic's reliance on "other" services for cost allocation and recovery

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[53] $(\$0.0354 \times 79) \div .35 = \$7.99$

[54] Direct Case at 76.